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SUBJECT: PLAN TO DEREGULATE VIETNAM'S POWER SECTOR LAGS DESPITE
SUPPLY SHORTAGES

HANOI 00000211 001.2 OF 002

¶1. (U) Summary: The Government of Vietnam (GVN) raised retail electricity rates by an average of around 9 percent from March 1 to reflect higher costs of power generation and encourage private investment in Vietnam's underfunded power sector. Vietnam expects electricity demand to rise sharply over the medium term. Meeting this demand will pose a serious challenge to the GVN, which is studying a plan to liberalize Vietnam's antiquated and state-subsidized power sector, a proposal that is opposed by the state-run utility monopoly. Increasing the level of private investment could prove difficult since foreign energy company officials say the new tariff is not high enough to permit profitable power generation, and current investors report ongoing barriers to entry. End summary.

GVN INCREASES RETAIL TARIFF DESPITE RECESSION

¶2. (U) Starting March 1, the GVN increased the average retail price of electricity from VND 860/kWh (5 cents/kWh) to VND 948.5/kWh (5.56 cents/kWh), an increase of 8.92 percent. The new rate ranges from VND 435 to 1900/kWh for industrial users and VND 600 to 1790/kWh for residential customers. The government will continue to subsidize up to 40 percent of the cost of electricity for poor and low-income earners who use less than 50 kWh per month. The long-awaited rate increase, which the government announced in 2008 and then postponed as inflation soared to a high of 28 percent last year, comes as Vietnam's economy has slumped due to the global recession.

¶3. (U) While some have criticized the rate increase, saying it would exacerbate Vietnam's plummeting economic conditions, the government asserted that a 10 percent or less increase would not negatively affect the economy. Pham Manh Thang, the Director General of Vietnam's Electricity Regulatory Agency (ERAV) said the former price was based on economic data from 2005 and did not reflect inflation. Deputy Prime Minister Hoang Trung Hai also defended the decision, saying, "the increase is inevitable and may have even come too late." Vice Minister of Industry and Trade (MOIT) Vu Huu Hao said the price increase was needed to raise investment in Vietnam's underfunded electricity sector.

THE DEREGULATION CHALLENGE

¶4. (U) State-owned utility company Electricity of Vietnam (EVN) currently accounts for more than 70 percent of Vietnam's power generation, 100 percent of transmission and 95 percent of distribution. MOIT, which exercises a regulatory role over Vietnam's power sector, recently proposed to end EVN's public monopoly by unbundling the utility company's generation, transmission and distribution activities, and divesting the company of its 17 power plants. Those plants, plus any plants that come

online through 2015 would be consolidated into five or six independent, state-owned power companies, three of which EVN would still control. Under the plan, none of the new power companies would be allowed to generate more than 25 percent of Vietnam's national capacity. MOIT says the proposal is in-line with the GVN's three-phase deregulation roadmap, approved in 2006, whereby a competitive electricity generation market would emerge by 2014, and wholesale and retail markets by 2022.

¶5. (U) EVN, unhappy with the proposal, complained in a letter to the government (that was subsequently released to the press) that deregulation would be "inappropriate," endanger EVN's status as a strong, state-owned economic group and put national energy security at risk. EVN Deputy Director General Dinh Quang Tri said unbundling companies from EVN before the new ventures had a chance to establish financial credibility and management skills would jeopardize critical new power projects. EVN, he said, was the only company in Vietnam capable of operating the power plants at a competitive cost.

UNTANGLING THE POWER LINES

¶6. (U) Even if deregulation wins government approval, increasing the level of private investment in Vietnam's power sector could prove difficult. Current and potential investors report ongoing barriers to entry in the sector, citing in particular the overly complicated and ambiguous investment procedures. Dang Thi Hoang Yen, Chairwoman of the Tan Tao Group, a local IPP developing a power project, complained that investors must fulfill a litany of complicated administrative procedures and win approval from multiple ministries and agencies, even for projects already approved by the Prime Minister.

¶7. (U) Low profitability is a second barrier. A recent report by

the United Nations Conference on Trade and Development (UNCTAD) noted that few foreign investors have been willing to invest in Vietnam's power sector due to the lower than average electricity tariff. In 2008, EVN purchased electricity from IPPs at 8-15 cents per kWh and sold it to consumers at a government-set rate of 5 cents per kWh. EVN was forced to make up these losses through its profitable telecom and banking arms.

¶8. (U) Representatives from the American Chamber of Commerce in Hanoi's Energy Committee said Vietnam's electricity tariff remains below rates in neighboring countries even after the latest price increase and could make it difficult to ensure profitability and attract IPPs. The low tariff invariably leads to protracted negotiations. Dinh La Thang, Chairman of state-run PetroVietnam (PVN), said it took his company two years merely to negotiate an electricity price for the 1,500 MW Ca Mau 1 and Ca Mau 2 gas-fired power plants operated by PVN. Similarly, it took U.S. power company AES nearly two years to negotiate a tariff price for AES's proposed 1,200 MW Mong Duong 2 power plant.

¶9. (U) Despite the barriers, Vietnam's power sector holds promise for persistent investors. When EVN refused to take on 13 electricity projects last year, citing a lack of funding, several local enterprises, including state-run PetroVietnam, Vinacomin and six foreign companies, stepped forward to bid on the projects. As the projects were already listed in the Electricity Master Plan, the investors were not required to win approval for these ventures. In November 2008, Deputy Prime Minister Hoang Trung Hai (who oversees Vietnam's the energy sector) reallocated several coal-fired projects to IPPs, including Malaysia's Janakusa, and additional opportunities should be expected as the sector undergoes further deregulation.

MEANWHILE, EXPECT MORE BLACKOUTS

¶10. (U) Even as the government mulls deregulation, Vietnam will continue to suffer a deficit of electricity, even more so during the dry season given the country's significant dependence on hydropower. EVN has committed, however, to minimize disruptions in 2009. "This

is a serious issue that we need to deal with," said Vice Minister of Planning and Investment Cao Viet Sinh. "If power projects fail to meet the deadline, Vietnam's economic development will be severely impacted in the years ahead." Observers point out that EVN may succeed in minimizing blackouts not due to improved capacity and efficiency, but merely due to decreasing demand and slumping industrial production in 2009.

¶11. (U) Under its most recent plan, EVN expects electricity growth rates to grow sharply over the medium-term due to industrial expansion and increasing demand for consumer electrical products. Vietnam generated 73.7 billion KWh of electricity in 2008 and plans to provide the grid with around 83.2 billion kWh in 2009, of which EVN will generate around 70 percent. IPPs, foreign-invested BOT projects (build-operate-transfer) and electricity purchases from China will fill the remaining 30 percent.

¶12. (U) Comment: Investors will participate in Vietnam's power sector only if the electricity industry's structural, legal and regulatory frameworks are in place. Competitive electricity prices and long-term commercial terms also must be ensured. Given the expected high demand for electricity in Vietnam over the next decade and the country's limited success in attracting private investment in the power sector to date, Post will continue to urge the GVN to expedite plans for sector liberalization, since it would provide opportunities for U.S. firms.

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